



Frequently-Asked Questions about the Federal Over-Recovery Issue

February 3, 2004

- 1. *What is the federal over-recovery issue and how does it affect a state's budget?*** When states work with the federal government to operate programs, the federal government pays a portion of the direct and indirect costs. Federal standards for states to use in recovering such costs, published as early as 1970, are based on the principle that the federal government should pay its fair share of the direct and indirect costs associated with federal grants and contracts.

States and the federal government often differ in their interpretation of the fair allocation of costs. If the federal government determines that a state has sought more federal dollars than they have supplied in required matching funds or billed the federal government at a higher rate than other users of the same service, they will seek recovery of a share of their costs. It is also possible that the federal government will levy fines or halt program funding.

- 2. *What is the history of Iowa's federal over-recovery problem?***

The Iowa problem with information technology over-recovery began in 1995. To date, the federal government has not made use of the maximum interest and penalties allowed by law. Iowa has made paybacks for a number of years, including the following recent IT-related payments:

FY 2000	\$457,870
FY 2001	\$507,504
FY 2002	\$517,638
FY 2003 (anticipated)	\$1,518,000

(Repayments for over-recoveries associated with Vehicle Dispatch and Communications have also been made previously from related revolving funds.)

- 3. *How did federal over-recovery become an issue for information technology?***

Information technology is a relatively new part of state government. As state agencies began utilizing new technology, they set up different funding methods that continued when the old Information Technology Department (ITD) and its responsibilities were defined. Some state departments that received significant federal funding, like the Department of Human Services, were paying high IT costs. The federal government determined that a portion of those costs were recoverable.

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4. *How will the requested \$3 million General Fund appropriation be used?*

The Department of Management will use the appropriation as a portion of Iowa's projected match in requesting federal reimbursement for IT expenses.

5. *How can the over-recovery problem be permanently resolved?*

Under the entrepreneurial management approach implemented by the Department of Administrative Services (DAS), a careful study has been conducted to determine the actual costs to provide ITE utility services for which purchase is mandatory. The DAS Information Technology Enterprise (ITE) has improved its financial reporting capabilities to enable better tracking of its actual direct and indirect costs. The ITE Customer Council used this information to set pricing for ITE utility services for FY 2005 that reflects these actual costs. ITE will ensure that full costs of the state's new I/3 information technology system are recovered from user payments in FY 2006

ITE is also recalculating its expenses for marketplace services, those services for which DAS customer agencies may choose any vendor. ITE has also reduced its own spending in a manner that made it possible to reduce current mainframe rates by 12 percent.

6. *Will funding the \$3 General Fund appropriation request solve Iowa's IT-related federal over-recovery problem?*

Funding the requested \$3 million appropriation will help resolve the current IT over-recovery problem. The permanent solution is for the DAS to charge its customers the actual costs of providing IT services and for those customers to receive funding that enables them to pay for the services they receive. As new IT services like I/3 are introduced, it will be important to assure that system users receive the funding necessary to cover their costs so that the over-recovery problem does not happen again.

7. *Why can't we wait to resolve this issue when state finances are looking better?*

In FY 2002, Governor Vilsack's budget recommended providing \$2 million to resolve this issue, and his FY 2004 budget includes \$3 million. At a time when the federal government is running record deficits and seeking to cut domestic spending, it is reasonable to expect closer scrutiny of this issue. Failure to resolve the problem may cause the state to incur significant financial penalties and/or interest charges and the possibility of a mandated suspension of Iowa's indirect cost allocation program, which provides more than \$20 million in federal payments to Iowa.